

## Contract Advisory

2009-5

April 6, 2009

### **Guidelines for Price Escalation Clauses in Consultants Priced Proposals**

Many of our consultant contracts cover multiple years. After consultant selection and negotiations with the MDOT Project Manager, a priced proposal is received. Often, for multiple year contracts, the priced proposal includes an annual hourly rate escalation for consultant employees. Effective today, the information below provides guidelines for the handling of price escalation clauses:

- All consultant contracts with a duration of less than one year may not have any price escalation documented in the priced proposal for the prime consultant and any subconsultants.
- For contracts that extend beyond one year, any price escalation clause may not exceed 2% per year.

Project Managers should contact consulting firms and renegotiate pending agreements with escalation clauses prior to the contract approval. This guidance should be used to negotiate all consultant contracts until further notice.

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Questions regarding this  
Contract Advisory  
should be directed to:

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**From:** Wayne E Roe JR  
**To:** Rademacher, Carol R.  
**Date:** 4/6/2009 8:47AM  
**Subject:** Fwd: Re: Consultant Contracts - Escalation Clauses

>>> Kirk Steudle 4/3/2009 9:12AM >>>

Yes. This can be done quickly and still get to the next SAB meeting.

We don't need to change the whole process just this clause and the amount of potential increase.

For the longer term discussion it would be helpful to know how much contract wages have increased under this provision. Has 4% been used, if so how often? If not what is the % used by year.

Kirk

Kirk

BlackBerry Message

"One fatality is one too many"

-----Original Message-----

From: Myron Frierson  
Cc: Blaxton, Vanessa <blaxtonv@michigan.gov>  
Cc: Hank, Leon <HankL@michigan.gov>  
To: Steudle, Kirk <SteudleK@michigan.gov>  
Cc: Johnson, Gregory <JohnsonG2@michigan.gov>  
Cc: Jones, Jerry <JonesJ@michigan.gov>  
Cc: Roe JR, Wayne E <ROEW@michigan.gov>  
Cc: Shinn, Jackie <ShinnJ@michigan.gov>  
Cc: VANPORTFLEET, MARK <VANPORTFLEETM@michigan.gov>

Sent: 4/2/2009 10:26:10 PM

Subject: Re: Consultant Contracts - Escalation Clauses

I'll contact the applicable region engineer for each contract and asked them to have the contracts renegotiated as you suggested or wait until we develop a long-term solution. Hopefully, we can get the contracts on the next SAB agenda. We'll start conversation with the ACEC on a long-term solution, but adopt your suggestion in the interim as means to continue processing contracts in the selection process. We will issue a contract advisory to explain this change to project managers.

Do you concur with this approach?

>>> Kirk Steudle 04/02/09 5:18 PM >>>

I do not.

One contract is a one year CE contract, why is there an escalation clause even in the contract? The others should be complete within two, why are there four years worth of increase?

An escalation clause is ok in the contract but in these times, it should not allow a consultant to raise their wage rates by 4% per year over the life of the contract. 1% or at most 2% should be the maximum.

At a time when companies are cutting wages by 20% (visteon) there is no way we should be approving contracts that, on the surface would allow for a 16% increase in wages. We are not in the economic times of the past and it is time to start thinking about perception and preserving our ability to control our costs.

If this went through as is, please explain the public message.

My suggestion is to delete the escalation clause for the one year contracts, and process it. The others reduce the time frame and the maximum percentage to 2%.

Kirk

however, in the meantime continue to process consultant agreements as negotiated.

Please advise if you concur with my recommendation.

Myron

Myron G. Frierson, Director  
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Michigan Department of Transportation  
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BlackBerry Message  
"One fatality is one too many"

-----Original Message-----

From: Myron Frierson  
Cc: Blaxton, Vanessa <[blaxtonv@michigan.gov](mailto:blaxtonv@michigan.gov)>  
Cc: Hank, Leon <[HankL@michigan.gov](mailto:HankL@michigan.gov)>  
To: Steudle, Kirk <[SteudleK@michigan.gov](mailto:SteudleK@michigan.gov)>  
Cc: Johnson, Gregory <[JohnsonG2@michigan.gov](mailto:JohnsonG2@michigan.gov)>  
Cc: Jones, Jerry <[JonesJ@michigan.gov](mailto:JonesJ@michigan.gov)>  
Cc: Roe JR, Wayne E <[ROEW@michigan.gov](mailto:ROEW@michigan.gov)>  
Cc: VANPORTFLEET, MARK <[VANPORTFLEETM@michigan.gov](mailto:VANPORTFLEETM@michigan.gov)>

Sent: 4/2/2009 9:33:42 AM  
Subject: Consultant Contracts - Escalation Clauses

Director,

In response to your inquiry the use of price escalation clauses, several consultant agreements are on hold. For example, three agreements totaling approximately \$2.8 million were removed from yesterday's T&NR meeting agenda:

A contract with Tetra Tech of Michigan, P.C., for design services for the reconstruction of US-24 in Brownstown Township, Wayne County, \$1,256,476.57.

A contract with HNTB Michigan, Inc., for full construction engineering services for the reconstruction of M-49 in the Village of Allen and M-99 in the City of Litchfield, Hillsdale County, \$467,656.18.

A contract with URS Corporation Great Lakes for design services for the US-131 bypass of the Village of Constantine, St. Joseph Count, \$1,075,979.30.

Several more agreements are being held from further process pending resolution of this matter. The use of escalation clauses has been a long standing practice, that needs to be evaluated for its effectiveness and any changes regarding its use should be discussed with industry before making a unilateral change. I very concern about meeting program delivery schedules dependent on the execution of these agreements.

I recommend that within the next 30 days the department makes a decision on the continued use of escalation clauses, however, in the meantime continue to process consultant agreements as negotiated.

Please advise if you concur with my recommendation.  
Myron

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**From:** Myron Frierson  
**To:** Chaput, Mark; Friend, John; Kratofil, Tony; Ness, Brian; Roe JR, Way...  
**CC:** Hank, Leon; Johnson, Gregory; Jones, Jerry; Rademacher, Carol R.; St...  
**Date:** 4/6/2009 9:00AM  
**Subject:** Consultant Agreement Escalation Clauses  
**Attachments:** Myron Frierson.vcf

In response to concerns raised regarding the use of price escalation clauses, several consultant agreements are on hold. For example, here are some of the contracts being held:

A contract with Tetra Tech of Michigan, P.C., for design services for the reconstruction of US-24 in Brownstown Township, Wayne County, \$1,256,476.57.

A contract with HNTB Michigan, Inc., for full construction engineering services for the reconstruction of M-49 in the Village of Allen and M-99 in the City of Litchfield, Hillsdale County, \$467,656.18.

A contract with URS Corporation Great Lakes for design services for the US-131 bypass of the Village of Constantine, St. Joseph County, \$1,075,979.30.

A contract with Tyme Engineering for full construction engineering services for replacement of two bridges on M-19, St. Clair County, \$452,007.24.

Fleis & Vandenbrink Engineering,  
Several more agreements are being held from further processing pending resolution of this matter, CSD contract administrators will contact the applicable project manager regarding agreements being held.

To address meeting program delivery schedules dependent on the execution of these agreements, project managers should use the following interim measures:

1. Consultant contracts with a duration of less than one year should not have an escalation clause.
2. For contracts that extend beyond one year, any escalation clause should not exceed 2 percent per year.

Project managers should contact consultant firms and renegotiate pending agreements with escalation clauses as soon as possible if they wish to have their contracts approved for further processing. This interim guidance should be used to negotiate consultant agreements until further notice.

The use of escalation clauses has been a long standing practice that needs to be evaluated for its effectiveness. Any long-term changes regarding their use will be discussed with industry. We hope to have develop a long-term solution regarding this matter as soon as possible.

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**DATE:** March 12, 2009

**TO:** Kirk T. Steudle, Director

**FROM:** Wayne E. Roe, Jr., Division Administrator

**SUBJECT:** Consultant Contracts - Annual Employee Hourly Rate Escalation

On March 3, 2009, Carol Rademacher and I met with Leon Hank to discuss the current contract provisions as well as department practice relative to consultant employee annual hourly rate escalations. He requested that I provide you with this information along with alternatives/options to these current practices.

**Current Practice**

Many of our consultant contracts cover multiple years. After the consultant has completed negotiations with a MDOT Project Manager, a priced proposal is submitted, identifying all costs for the contract. For those contracts in which payment is made on a cost plus fixed fee basis, the costs are identified and reported by direct labor, other direct costs, overhead and fixed fee for profit. Many, if not most, multi-year consultant contracts include an annual hourly rate escalation, ranging from 1% – 5%, for consultant employees. It has been MDOT's standard practice to approve these rate escalations. MDOT's standard Indefinite Delivery of Services (IDS) contract states:

"Payment for costs of services that will be reimbursed on an actual costs plus fixed fee basis is in accordance with the following terms: Direct Salary costs: Actual labor costs of personnel performing services. This cost will be based on the employees' **actual hourly rates of pay** and the actual hours of performance on the services, as supported by employee time and earning records."

In discussions with the Office of Commission Audits (OCA), it was determined that for those contracts over \$100,000 in which priced proposals are reviewed, an annual hourly rate increase of 1% - 5% is considered reasonable, if the hourly rates are actual, and can be verified to certified payroll reports. For those contracts under \$100,000, which are not reviewed by OCA, Contract Services Division (CSD), has also considered this escalation reasonable, and has approved them as well.

**Alternative Options to Current Contract Language and Current Practice**

- Maintain current contract language and practices, thereby continuing to allow a reasonable annual hourly rate escalation. Although the actual total dollars are not known, the increases are generally not considered to be a material dollar amount.
- Work with industry representatives on acceptable basis of payment language that will modify rate increases during the term of future contracts.
- Negotiate with industry representatives to modify current contract language to modify escalation clause provisions.

If you would like to discuss this issue further, feel free to contact me at 3-4680

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Division Administrator